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BEFORE THE ARIZONA CORPORATION COMMISSION

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AZ CORP COMMISSION  
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IN THE MATTER OF THE PURCHASED GAS  
ADJUSTOR BANK BALANCE THRESHOLD  
LEVEL FOR UNS GAS, INC.

) DOCKET NO. G-04204A-05-0046

)  
) **RECOMMENDATIONS OF UNS**  
) **GAS, INC. REGARDING**  
) **THRESHOLD LEVEL**  
)  
)  
)

UNS Gas, Inc. ("UNS Gas" or "Company"), through undersigned counsel, hereby submits  
its recommendation for changes to the Purchased Gas Adjustor ("PGA") mechanism as follows:

**I. Introduction.**

In Decision No. 67730, the Arizona Corporation Commission (the "Commission") ordered  
that "Staff and the Company shall come up with a new threshold amount for the bank balance."  
On October 26, 2005, Commission Staff submitted its recommendation that the Commission  
approve an increase of the PGA bank balance threshold level from \$4,450,000 to \$6,240,000. [See  
Staff Memorandum and Proposed Order dated October 26, 2005].

UNS Gas does not oppose Staff's recommendation to increase the bank balance threshold  
to \$6,240,000. However, the Company believes that the same considerations that prompted the  
Commission to increase the threshold also require increases to the interest rate applied to the bank  
balance and the banding of the 12-month rolling average. The current PGA mechanism of a  
banded 12-month average was established in 1998 to balance the interest of providing greater  
price stability to customers against the financial impact on local distribution companies ("LDCs")  
of carrying sizeable bank balances. Simply increasing the bank balance threshold without  
commensurate increases in the interest rate applied to the bank balance and the banding of the

1 rolling average unduly skews the financial impacts of rising gas prices and a mounting PGA bank  
2 balance to UNS Gas. These impacts are significant and detrimental to the Company.

3 **II. UNS Gas' Recommendations.**

4 UNS Gas recommends that the following comprehensive changes to its PGA mechanism  
5 be adopted in connection with the proposed increase of the bank balance threshold from  
6 \$4,450,000 to \$6,240,000:

- 7 1) Change the interest rate on bank balances from a 3 month non-financial  
8 Commercial Paper rate to 3 month LIBOR ("London Interbank Offered Rate") plus  
9 1.50%, so long as the PGA bank balance is less than two times the threshold value  
10 (or \$12.4 million);  
11 2) Change the interest rate on bank balances that exceed two times the threshold to a  
12 rate equivalent to UNS' authorized rate of return; and  
13 3) Increase the banding of the 12-month rolling average of the PGA rate from \$0.10  
14 per therm to \$0.20 per therm.

15 UNS Gas believes that the foregoing additional changes to the current PGA mechanism are  
16 necessary to balance the adverse financial impacts that result from increasing the threshold and  
17 causing the Company to carry a significant and growing under collected PGA bank balance. The  
18 proposed changes are discussed below.

19 **A. Interest on the Bank Balance.**

20 UNS Gas recommends an increase to the rate of interest charged on its PGA bank balance  
21 because the current rate is well below the Company's actual cost to borrow funds. The Company  
22 has proposed two different rates based upon the existing bank balance.

23 **(i) Rate for bank balance below \$12.4 million.**

24 UNS Gas proposes an increase in the bank balance interest rate from the current 3-month  
25 commercial paper rate to LIBOR plus 1.5% on all balances below \$12.4 million dollars because  
26 the interest rate for UNS Gas' revolving line of credit is LIBOR plus 1.50%. LIBOR is a  
27 benchmark short-term interest rate that is published daily in the Wall Street Journal for one month,

1 three month, six month and 12 month maturities. Applying the current 3-month commercial paper  
2 rate to the Company's PGA bank balance, without any adjustment for the 1.5% credit spread  
3 actually paid by UNS Gas to borrow funds, imposes a significant interest burden on the Company.  
4 The annual difference between interest collected and interest incurred on an average PGA bank  
5 balance of \$12.4 million dollars is \$186,000. Even with the recently authorized PGA surcharge,  
6 UNS Gas projects that it will be forced to carry a PGA bank balance well in excess of \$12.4  
7 million dollars over the next 24 months. Therefore an increase in the bank balance interest rate to  
8 LIBOR plus 1.5% is reasonable and appropriate.

9 **(ii) Rate for bank balance above \$12.4 million.**

10 UNS Gas also proposes to apply a stepped-up rate to bank balances that exceed \$12.4  
11 million dollars because such significant balances will be carried for a longer time period and are  
12 analogous to working capital. These high balances should accrue interest at a rate equivalent to  
13 that charged for working capital – a return equivalent to UNS Gas' authorized rate of return for  
14 working capital.

15 Applying a higher rate of interest on bank balances that exceed \$12.4 million dollars is  
16 also appropriate given the credit limitations faced by the Company. UNS Gas has \$30 million of  
17 credit available under its revolving credit facility. This credit facility is also required to fund other  
18 working capital needs of UNS Gas as well as a large portion of capital expenditures. UNS  
19 Electric, Inc. also relies on the same credit facility (combined \$40 million) for its borrowing needs.  
20 Therefore, high bank balances that exceed \$12.4 million dollars should accrue interest at a rate  
21 equivalent to the Company's authorized rate of return.

22 **B. Banding of Rolling Average.**

23 Finally, UNS Gas recommends an increase in the banding of the 12-month rolling average  
24 PGA rate from \$0.10 per therm to \$0.20 per therm. UNS Gas believes it is appropriate to increase  
25 the banding for the same reasons it is appropriate to adjust the threshold – increased cost and  
26 volatility of the natural gas market. The increase in the band from \$0.10 to \$0.20 will still limit  
27 fluctuations in the PGA rate that customers experience on their bills while at the same time

1 providing accurate price signals to customers and limiting the accrual of under collected balances.  
2 Further, if the proposed change is adopted, during a period of declining gas prices, customers will  
3 see a faster reduction in the PGA rate than seen in the existing \$0.10 per therm limit.

4 The 12-month banding applied to UNS Gas' bank balance has been modified at least twice  
5 since 1998. The first instance occurred in Decision 62294 when the Commission approved a  
6 change from \$0.07 to \$0.10 for all LDCs and the second change to \$0.15 for a period of twelve  
7 months following Commission approval of the UniSource Energy Corporation's acquisition of  
8 Citizens' gas properties. [See Decision 66028]. It is again appropriate to adjust the banding from  
9 \$0.10 to \$0.20 per therm in connection with increasing the bank balance threshold.

10 **III. Conclusion.**

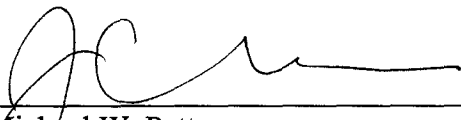
11 Based on all of the foregoing, UNS Gas recommends that in connection with the proposed  
12 increase of the PGA bank balance threshold from \$4,450,000 to \$6,240,000, that the Commission  
13 also adopt the following additional changes to the PGA mechanism:

- 14 1) Change the interest rate on bank balances from a 3 month non-financial  
15 Commercial Paper rate to 3 month LIBOR ("London Interbank Offered Rate") plus  
16 1.50%, so long as the PGA bank balance is less than two times the threshold value  
17 (or \$12.4 million);
  - 18 2) Change the interest rate on bank balances that exceed two times the threshold to a  
19 rate equivalent to UNS' authorized rate of return; and
  - 20 3) Increase the banding of the 12-month rolling average of the PGA rate from \$0.10  
21 per therm to \$0.20 per therm.
- 22  
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1 RESPECTFULLY SUBMITTED this 2<sup>nd</sup> day of November 2005.

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17 Original and 13 copies of the foregoing  
18 filed this 2<sup>nd</sup> day of November 2005 with:

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23 Copy of the foregoing hand-delivered/mailed  
24 this 2<sup>nd</sup> day of November 2005 to:

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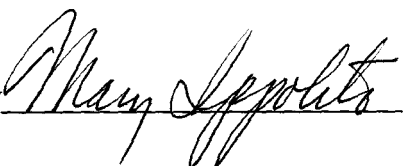
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